No. 76-1547

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

SAMUEL H. SLOAN and SAMUEL H. SLOAN
d/b/a SAMUEL H. SLOAN & CO.,
Petitioners,

-against-

SECURITIES & EXCHANGE COMMISSION, et al.,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

PETITIONER'S REPLY BRIEF

SAMUEL H. SLOAN
Petitioner pro se
1761 Eastburn Avenue, Apt. A5
Bronx, New York 10457
(212) 864-5770

Dick Bailey Printers, 290 Richmond Ave., Staten Island, N.Y. 10302
Tel.: (212) 447-5358

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PETITIONER'S REPLY BRIEF

The petition for a writ of certiorari was filed on May 9, 1977. Respondent, the Securities & Exchange Commission ("S.E.C."), had 50 days to file a brief in opposition. See Supreme Court Rule 24(1). Therefore, the time to file a brief in opposition expired on June 28, 1977. No extension of time was requested or obtained by the S.E.C. and no brief in opposition was filed until July 20, 1977. Thus, the brief in opposition was filed without permission more than three weeks late. It is submitted that the brief in opposition is not in compliance with the rules of this Court with respect to timeliness and therefore should not be received and consequently the S.E.C. should be declared to be in default.

It is noteworthy that part of the basis for the administrative proceeding which is the subject of this petition for a writ of certiorari is the claim that Petitioner willfully violated S.E.C. reporting requirements by filing certain financial reports late. The administrative decision of the S.E.C. found that Petitioner had filed a Rule 17a-5 report of financial condition for the calendar year 1970 four months late and a Rule 17a-10 report of income and expenses for the same year eight months late (Pet. App. 32a, no. 16). The brief in opposition cites these delinquencies as a major part of the basis for the decision of the S.E.C. to bar Petitioner for life from being associated with any broker or dealer (See Brief in Opposition p. 4). Although the three weeks lateness by the S.E.C. in filing its brief to this Court is less than the four to eight months Petitioner was found to be late in filing his S.E.C. reports, the principle is the same. Surely the S.E.C. and the Solicitor General are under as much obligation to comply with the rules of this Court with regard to timeliness as Petitioner was under to comply with the rules of the S.E.C. Inasmuch as the S.E.C. has been unwilling or unable to comply with the rules of this Court with respect to the time for filing required briefs, it should not be permitted to impose the Draconian penalty of a lifetime bar upon Petitioner for a similar failure to comply with an S.E.C. rule. Accordingly, this petition for a writ of certiorari should be granted and the order of the S.E.C. invoking sanctions should be vacated.

In addition to being late, the brief in opposition is objectionable in that it adopts positions totally contrary to principles established by innumerable decisions of this and lower federal courts. For example, points 2 and 5 of the brief in opposition (Brief 6, 8) assert that the petition presents "purely factual issues" which "do not warrant further review." This is not true. These claims refer to questions presented to this Court concerning whether there is sufficient substantial evidence in the record to support the findings and the orders issued by the S.E.C. All federal appellate courts are in agreement that an issue

involving the substantiality of the evidence present a question of law, not of fact.

In point 5 of the brief in opposition (Brief p. 8), the S.E.C. asserts that "there is no occasion for further review of [the] factual determination," by the Court of Appeals that "there was sufficient evidence of probable manipulation of CJL's common stock and of the false and fraudulent representations as to its soundness and value to justify the Commission's conclusion . . . summarily to suspend trading." (Brief p. 8; Pet. App. 44a). Clearly, in the quoted passage the Court of Appeals did not make a factual determination but rather in its own words made a legal determination regarding the sufficiency of the evidence needed to support a trading suspension. Contrary to the position asserted by the S.E.C., there is no governing principle which prohibits review of that ruling by this Court. Indeed, review of the determination by the Court of Appeals on this point is astonishingly simple since the entire record of the particular trading suspension in question consists of two pieces of paper which are reproduced on pages 54a-55a of the petition. It is a simple matter to read these two pieces of paper and observe that nowhere on either of them is there a statement that there have been "false and fraudulent representations as to [Canadian Javelin Ltd's] soundness and value." Accordingly, the decision of the Court of Appeals is clearly erroneous. Indeed, although one of the documents in question once uses the term "manipulative activities" and twice uses the term "manipulation" (Pet. App. 55a), it does not provide any hints or clues as to the nature of the manipulation. In other words, the situation here is similar to that presented in *Buchman v. S.E.C.*, 553 F. 2d 816, 821 (2d Cir. 1977) where the S.E.C. warned brokers that there might be a manipulative scheme afoot but, after seven months of investigation, did not disclose the nature of the manipulation or who the culprits were. In short, the decision of the Court of Appeals is clearly in error with regard to the evidence supporting the reasons and justification for the trading suspension and contrary to the assertions by the S.E.C. there is nothing of a

factual nature that need be determined by this Court if it decides to grant the petition.

With further regard to this point, it is noteworthy that the cross petition for a writ of certiorari filed by the S.E.C. (No. 76-1607) which, according to the brief in opposition (Brief p. 5, n. 2) involves an "issue distinct from any of the issues Petitioners raise" relies on the same two documents that are included on pages 54a-55a of the appendix to the instant petition. However, in an apparent attempt to obfuscate the issues being presented to this Court, that petition refers this Court to two pages of the appendix in the Court of Appeals (See Petition in 76-1607, p. 3 and n. 2) and that appendix is not presently available to this Court and therefore cannot easily be read by the judges of this Court. The fact is that the pages cited in the cross petition as "C.A. App. A-11, A-12" are the same as pages 54a-55a in the appendix to the instant petition but presumably the S.E.C. prefers not to clarify this matter in order to avoid the embarrassment of having it become painfully obvious that there was no legal, factual or evidentiary justification for even the initial suspension of trading in Canadian Javelin Ltd.[1]

There can be no doubt that the S.E.C. is aware of pronouncements by justices of this Court that it does not sit to vindicate the rights of individual litigants or to resolve disputed issues of fact but rather it sits to resolve important legal questions. It is apparent that for this reason the S.E.C. has asserted falsely that "purely factual issues" are presented by this petition. Such tactics are highly censurable. In addition, it is noteworthy that the statement in the brief in opposition that there is no need for "further review" of the "factual issues" raised (Brief p. 6, point 2) is misleading because it appears that

1. It is noteworthy that the cross petition asks this Court to grant "summary reversal" of the decision of the Court of Appeals (See Pet. 12, n. 8). Presumably, the S.E.C. is hoping that this Court will grant that request without examining the record and consequently will never become aware of the flimsy basis for the year-long trading suspension of securities of Canadian Javelin Limited.

the Court of Appeals did not review the evidence. If the Court of Appeals did review the evidence, it made no mention of the fact (See Pet. App. 41a).

Several of the other arguments presented in the S.E.C.'s brief in opposition require comment. In addition, since the time of the filing of the petition for a writ of certiorari three courts of appeals have rejected the contentions of the S.E.C. based upon circumstances indistinguishable from those presented in the instant case. Those decisions come from the Third, Eighth, and District of Columbia Circuits and they create a conflict of decision between those circuits and the Second Circuit, although they pertain to matters not explicitly discussed in the decision of the Court of Appeals. A discussion of the above matters follows.

I

In three recent decisions of the Court of Appeals the contentions advanced by the S.E.C. in those cases which were also advanced by the S.E.C. in the instant case were rejected. The first of these was *Todd & Co., Inc. v. S.E.C.*, 557 F. 2d 1008 (3rd Cir. 1977). In that case, the Court of Appeals vacated an order of the S.E.C. on the grounds that Todd & Co., Inc. had not received notice of the charges. The situation there was closely analogous to the situation presented here where, as the petition points out, approximately half of the reasons given in the decision of the S.E.C. for revoking Petitioner's broker-dealer registration and barring Petitioner for life from being associated with any broker or dealer concerned events which took place after the administrative hearing was concluded. In fact, the lack of notice here was considerably more egregious than that involved in *Todd & Co.* In that decision, the Court of Appeals stated:

> 'The statute and rules are clear: a party being sanctioned or disciplined must have notice of the charges . . .

> The S.E.C. admits that "the Board reversed the District Committee's dismissal of the first charge without notice to respondents," but argues that "the Association's error, if any, was patently harmless," since both charges "turn on the same facts." We disagree. . . . The S.E.C. . . . should not cavalierly dismiss procedural errors affecting the rights of those subjected to sanctions but should insist upon meticulous compliance by the private organization." 557 F. 2d at 1014.

The next setback the S.E.C. received came in a decision from the Eighth Circuit in *Wasson v. S.E.C.*, No. 76-1665, decided June 21, 1977, CCH Fed. Sec. Law Rep. ¶96,092 [Current Binder]. In that case, the order of the S.E.C. was affirmed but only after the Court of Appeals held that a negligence-related standard was insufficient for determining "willfulness." The Court of Appeals held that the concept of willfulness in an administrative proceeding before the S.E.C. "implies something more than mere negligence," citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 209 n. 28 (1976). In the instant case, the S.E.C. applied a much lower standard of willfulness and stated that "An act is 'willful' within the meaning of that word as used in Section 15(b) of the Exchange Act even if the actor does not intent to violate the law" (Pet. App. 31a, n. 14). It was necessary for the S.E.C. to apply a standard similar to that applied in negligence cases in order to invoke sanctions against Petitioner since the findings of the S.E.C. concern such matters as tardiness in filing financial reports on behalf of Petitioner by Petitioner's accountant, which at most demonstrate negligent conduct on the part of Petitioner. There was no finding that the filings were so late as to diminish their value in serving the purposes intended by the requirements for filing the reports. The decision of the S.E.C. relies upon two decisions from the Second Circuit as authority for applying a low standard for determining "willfulness": *Tadger v. S.E.C.*, 344 F. 2d 5, 8 (2d Cir. 1965); and *Gearhart & Otis Inc. v. S.E.C.* 348 F. 2d 798.

802-803 (D.C. Cir. 1965). The S.E.C. continued to rely on these decisions in its brief to the Court of Appeals. Accordingly, there is a conflict of decision between the Second Circuit and the Eighth Circuit which it would be appropriate for this Court to resolve. This is particularly true since even since *Wasson* the S.E.C. has continued to maintain that the holding in *Ernst & Ernst v. Hochfelder* is inapplicable to administrative proceedings instituted by the S.E.C. *In the Matter of Steadman Security Corporation*, Securities Exchange Act Release No. 13695, 12 SEC Docket 1042, 1050 (June 29, 1977).

In *Wasson v. S.E.C., supra*, the order of the S.E.C. was affirmed because the Court of Appeals, after applying the higher standard for determining willfulness, determined that Wasson's conduct had been willful. The Court of Appeals held that the S.E.C. had correctly found that Wasson had illegally engaged in the fraudulent distribution of unregistered securities. The sanction invoked in that case, a 45-day suspension of a registered securities salesman, was relatively mild.

In the third case, *Collins Securities Corp. v. S.E.C.*, No. 75-2200, CCH Fed. Sec. Law Rep. ¶96, 122 [Current Binder] decided by the District of Columbia Circuit on August 12, 1977, the Court of Appeals held that "clear and convincing evidence," not "preponderance of the evidence," is the standard of proof in an administrative proceeding before the S.E.C. in cases where an expulsion or substantial suspension order is issued as a sanction. The "preponderance of the evidence" standard was applied in the instant case (see Pet. App. 10a) and according to the decision in *Collins Securities Corp., supra*, n. 15 it has been consistently applied as "the Commission's own interpretation of its case law of the proper standard." In *Collins* the Court of Appeals found it inappropriate to engage in a detailed discussion of the evidence and instead remanded the case to the S.E.C. with instructions to consider the evidence under the "clear and convincing evidence" standard. That decision, if followed here, would require the same result. Again, even recently the S.E.C. has stated that the "preponderance of the evidence," not "clear and convincing

evidence" is the correct standard. *In the Matter of Steadman Security Corp., supra,* 12 SEC Docket at 1060 n. 88. These decisions involving the appropriate evidentiary standard to be applied further demonstrate the falsity of the claim in the brief in opposition that the points raised in the petition concerning the sufficiency of the evidence raise "purely factual issues."

II

In an egregious error, the Court of Appeals held that an injunction is "in itself a sufficient ground to support the revocation" of a broker-dealer registration (Pet. App. 41a). Having gotten a better decision than it asked for, the S.E.C. now urges that this holding by the Court of Appeals is correct (Brief in Opposition, p. 6, point 2). However, the administrative deference rule applies here and the S.E.C. has consistently held that there must be a finding of "public interest" based upon the record of an administrative hearing independent of a finding that an injunction has been entered, in order for sanctions to be invoked under § 15(b)(5) and § 15(b)(7) of the Securities Exchange Act. For example, *In Re Amswiss International Corp. and Glenn Woo,* CCH Fed. Sec. Law Rep. ¶80, 721 [1976 Transfer Binder] (decided September 8, 1976) was a case in which the Order for Public Proceedings alleged that respondents, a registered broker-dealer and its principal officer, had willfully violated the registration requirements and antifraud provisions of the securities laws and that they had been enjoined for these violations. In that case, the respondents filed an amended answer which admitted that they had willfully committed the alleged violations and which admitted that they had been enjoined as a result. Each of the injunctions was entered after the conclusion of a trial in a contested case and in each instance the district judge found that the respondents had engaged in serious criminal wrongdoing involving the distribution of unregistered securities and market manipulation. See *S.E.C. v. Cooper,* 402 F. Supp. 516, 521 (S.D.N.Y. 1975); *S.E.C. v. D'Onofrio,* CCH Fed.

Sec. Law Rep. ¶95, 201 [1975-1976 Transfer Binder]. The losses to the investing public were in excess of $1,000,000. The broker-dealer in question was the conduit through which one Ramon D'Onofrio executed a series of manipulative schemes. D'Onofrio has been characterized by the Court of Appeals as "ubiquitously criminal". *United States v. Frank,* 520 F. 2d 1287, 1289 (2d Cir. 1975).

In spite of all this, the existence of the injunctions were deemed to be insufficient and a lengthy hearing was conducted to determine if the imposition of sanctions would be in the "public interest". The decision subsequently rendered states (*In Re Amswiss International, supra,* p. 86, 869):

> "With all of the allegations of the Order having been admitted, and the violations having been found accordingly, the sole remaining issue litigated is the determination, in the "public interest," whether any sanctions should be imposed against respondents, and if so, the extent thereof.
>
> The general position of the Division is that respondents, having admitted to engaging in aiding and abetting a stock manipulation during the relevant period, and having been enjoined not only with respect thereto but also in another comparable securities situation, should be subjected to the severest sanction, namely, a complete bar from the securities business. Respondents, on the other hand, urge that because of circumstances occurring since the relevant period, the public interest would be served by the imposition of such lesser sanctions as would permit both Amswiss and Woo to continue in the securities business."

The decision cites a series of transactions in which Woo agreed to "front" for D'Onofrio, one of which resulted in D'Onofrio being indicted for and pleading guilty to a bankruptcy fraud. In addition to that, the decision found Woo had executed a series of market manipulations in D'Onofrio's behalf. As a result of this, it was decided that Woo would be

barred from association with any broker or dealer for eighteen months following which he could apply for leave to become associated with a broker or dealer in the performance of back office operations only. Amswiss International Corp. was suspended for a period of sixty days but the S.E.C. subsequently reduced the suspension to thirty days. See *In Re Amswiss International Corp.*, Securities Exchange Act Release No. 13011, 11 SEC Docket 10541 (November 26, 1976).

In light of the above, the assertion by the S.E.C. in the brief in opposition that the issuance of an injunction is "in itself" a sufficient ground to support a lifetime bar and that there need be no independent finding supported by substantial evidence that the sanctions invoked are in the "public interest" is ridiculous. This is particularly true since one of the injunctions relied upon here had been vacated prior to the time this case was heard by the Court of Appeals. See petition No. 76-982 (*cert. denied*, April 18, 1977). The above cited case also demonstrates the extreme severity of the sanctions invoked by the S.E.C. here.

III

In a matter involving statutory construction, p. 7 point 4 of the brief in opposition states that under Petitioner's interpretation of 15(b)(7)[2] of the Securities Exchange Act, which authorizes the S.E.C. to "bar or suspend for a period not exceeding twelve months any person from being associated with a broker or dealer," the word "suspend" would be "surplusage." The problem with this argument is under the S.E.C.'s own interpretation of the same statute the words "for a period not exceeding twelve months" are surplusage. This result occurs because the S.E.C. often imposes a "bar" for a period of finite duration exceeding twelve months. The petition cites one example of this in a case where the S.E.C. invoked a two-year bar (Pet. 33). There are many others. For example, in *Collins*

2. In this brief, the practice will be followed of citing to the statute as it existed at the time of the April 28, 1975 order of the S.E.C. invoking sanctions.

Securities Corp. v. S.E.C. supra, the S.E.C. ordered that "petitioner Collins be barred from association with any broker or dealer, provided that 'after two years, he may apply to the Commission to become so associated . . . '."

What the actions of the S.E.C. boil down to is that under the S.E.C.'s interpretation of §15(b)(7) the words "suspend" and "bar" have become terms of art so that when the S.E.C. wishes to exclude an individual from the securities business for a period of twelve months or less it uses the term "suspend" whereas when it wants to exclude an individual from the securities business for a longer period of time it uses the term "bar."

The S.E.C.'s interpretation of the statute is clearly improper. When Congress included the words "for a period not exceeding twelve months" in the statute, it clearly imposed a limit on the S.E.C.'s power, a limit which the S.E.C. has chosen to ignore. The situation here is similar to that presented with regard to trading suspensions where the applicable statute authorizes the S.E.C. to suspend trading in a security "for a period not exceeding ten days" and nevertheless the S.E.C. has interpreted the statute in such a way to give it the authority to invoke a trading suspension for an indefinite time period. Indeed, the S.E.C. has explained that the term "permanent bar" actually means a bar for an indefinite time period and "so-called lifetime bars are actually bars of indefinite duration." *In the Matter of Steadman Security Corp., supra*, 12 SEC Docket at 1064 n. 100.

Petitioner has been unable to locate any legislative history such as Congressional debates which shed light on the interpretation Congress intended for §15(b)(7), a provision which became law as a result of the 1964 amendments to the Securities Exchange Act. However, legislative history exists which makes it clear that this section is not being used here for the reason which Congress gave for its enactment. Both the House and the Senate Report state that §15(b)(7) is intended to overrule *Wallach v. S.E.C.*, 202 F. 2d 462 (D.C.Cir. 1953) which held that the S.E.C. may not join individuals other than registered broker dealers in

broker dealer revocation proceedings. See S. Rep. No. 379, 88th Cong., 1st Sess. 79 (1963); Hearings on Investor Protection before the Subcommittee of the House Committee on Interstate and Foreign Commerce, 88th Cong., 1st Sess. 228 (1963). In the instant case, the broker dealer in question is a sole proprietorship so a proceeding against the broker dealer is automatically a proceeding against the individual even without the benefit of §15(b)(7). However, through its expansive interpretation of §15(b)(7), the S.E.C. has in this case invoked the penalty of a lifetime bar which is a penalty far more severe than that permitted prior to the 1964 amendments to the statute.

As the petition notes (Pet. 33-34), the question presented with regard to this matter is one purely of statutory construction which can and ought to be decided by this Court. As is explained in more detail in the brief in opposition in No. 76-1607, which involves a similar statutory question dealing with trading suspensions, the "administrative deference rule" does not apply when the question presented is whether the administrative agency has exceeded the limits on its authority placed by Congress.

IV

The brief in opposition asserts on p. 7 point 3 thereof that the Court of Appeals was correct in ruling that the principles set forth in *Jones v. S.E.C.*, 298 U.S. 1 (1936) have no application to the instant case. However, the authorities which the S.E.C. cites in support of that conclusion reached precisely the opposite result. In *Peoples Securities Company v. S.E.C.*, 289 F. 2d 268, 269 (5th Cir. 1961) the Court stated that the question of whether a broker dealer has the right to withdraw its application for registration "turns on statutory construction and the applicability of *Jones v. S.E.C.*, 298 U.S. 1 (1936)." The Court then spent seven pages of detailed analysis of the facts and holdings of *Jones* and the decisional authority which developed as a result. At no time did the Court state or imply that *Jones* was inapplicable for the reason that it involved a securities registration rather than a broker dealer registration.

It is true that in *People Securities Company, supra* and in its companion case *Blaise D'Antoni Associates Inc. v. S.E.C.*, 289 F. 2d 276 (5th Cir. 1961) *rehearing denied* 290 F. 2d 688 (5th Cir. 1961), which the S.E.C. also cites, the Court reached the opposite result from that which Petitioner is urging here. The Court there held that *Jones* only applied in cases where the registration statement had not yet become effective. *Peoples Securities Company, supra,* 289 F. 2d at 272. In addition, the Court stated that at the time of the Jones decision it was illegal to offer a security for sale until its registration statement had become effective but in 1954 Congress had amended the Securities Act to permit applicants to make offers to sell during the period after filing but before the registration became effective, *Id.* at 273, and the Court reasoned that this change in the law meant that now there was a public interest in the contents of a securities registration statement immediately upon filing with the S.E.C. On this basis, the Court held that this public interest precludes an absolute right to withdraw a registration statement as opposed to the situation which existed at the time of *Jones* where the public interest was non-existant until the registration statement had become effective. The Court then said that the S.E.C. had concluded that *Jones* need not be followed. *Id.* At 273-274. From that point, the Court made an unexplained jump to the conclusion that there was similarly no absolute right to withdraw a broker dealer registration statement either before the statement had become effective, as was the case in *Peoples Securities Co., supra,* or after it had become effective, as was the case in *Blaise D'Antoni & Associates Inc., supra.*

Petitioner contends that this ruling was erroneous and seeks review of the issues involved in this Court. The reasoning of the decision of that Court of Appeals was predicated upon the presumption that the controlling consideration in *Jones v. S.E.C.* was the non-existance of any public interest in the registration statement which was the subject of that case. *Peoples Securities*

Co., supra, at 272. However, nowhere in the opinion of the Court in *Jones v. S.E.C.* are the words "public interest" to be found, which is not surprising in view of the vague and general character of the term "public interest." It might be argued that the public or society as a whole has an interest in the detection and prosecution of the violators of any criminal statute regardless of whether an individual member of the public was or could have been adversely affected by the criminal violation. Under this or even more stringent definitions, there existed a "public interest" in the circumstances involved in *Jones* in spite of the fact that "so far as the record shows there were no investors, existing or potential, to be affected." 298 U.S. at 23.[3] Thus, the non-existence of any public interest could not have been the controlling consideration in *Jones*. Rather, the basis for the decision of this Court was that "a withdrawal accomplishes everything which a stop order would accomplish, as counsel for the commission expressly conceeded at the bar." 298 U.S. at 23. In *Jones*, the S.E.C. was attempting to achieve objectives which this Court deemed to be improper. Under the pretext of a stop order proceeding, the S.E.C. had issued a subpoena duces tecum requiring Mr. Jones personally to produce virtually all of his financial records for inspection by the S.E.C. staff. It was obvious that the S.E.C. was attempting to use the stop order proceeding as the basis for launching a general investigation into the affairs of Mr. Jones in order to lay the groundwork for a possible criminal prosecution. Consequently, this Court ruled that the S.E.C. was engaging in nothing more than "a fishing expedition. . . an undertaking which uniformly has met with

3. Incidentally, so far as the record in the instant case shows there were no investors, existing or potential, to be affected since Petitioner, as a matter of policy, did not do business with public investors. The S.E.C. staff was aware of this. For example, page 2 of a memorandum dated March 20, 1972, in which the S.E.C. staff requested the S.E.C. to institute the instant administrative proceeding, states that "the audit indicated that Sloan had no public customers and accordingly, a SIPC receiver has not been requested." This memorandum was recently released to Petitioner pursuant to the Freedom of Information Act.

judicial condemnation," 298 U.S. at 26, and which if allowed, would permit the S.E.C. to engage in "unlawful inquisitorial investigations" which were "among those intolerable abuses of the Star Chamber, which brought that institution to an end at the hands of the Long Parliament in 1640."

This point is further clarified in the dissenting opinion of Mr. Justice Cardozo. Again there is no discussion of the existence or non-existence of any "public interest" beyond doubts expressed as to "whether the public interest will be prompted by forgetting and forgiving." 298 U.S. at 30. Instead, the dissenting opinion said that the stop order proceeding should be permitted to go forward because it would provide an efficient means for developing the proof needed for a successful criminal prosecution. In this regard, Mr. Justice Cardozo stated:

> "[T]he act is explicit (section 22(c), 15 U.S.C. § 77v(c)) that a witness is not excused from testifying on the ground that the testimony required of him may tend to incriminate him or expose him to a penalty or forfeiture. . . . Inquiry by the commission is thus more penetrating and efficient than one by a grand jury where there is no statutory grant of amnesty to compel confederates to speak. . . . It is no answer to say that on the record now presented a crime has not been proved or even definitely charged. An investigator is not expected to prove or charge at the beginning the offenses which he has reason to suspect will be uncovered at the end." 298 U.S. 31.

Thus, the dissenting minority believed that a criminal grand jury type investigation forms a valid and proper rationale for an administrative proceeding before the S.E.C. and a majority of this Court held otherwise. Whether that decision still stands as the law of this land presents an important question which ought to be reviewed by this Court. It is submitted that contrary to the assertions by the S.E.C. in its brief in opposition, the case presented here squarely presents the issue of whether *Jones v.*

S.E.C., supra, is still authoritative or whether it is to be merely regarded as "one of the major defeats of New Deal legislation . . . not nearly so significant for its holding as it is to historians of the Supreme Court." *Peoples Securities Company, supra,* 289 F. 2d at 271 citing in Part I Loss, *Securities Regulation* 200 (1951 Ed.). In other words, the question is whether *Jones* is one of the decisions from a bygone era which "should not now be taken seriously," cf. *National Cable Television v. United States,* 415 U.S. 336, 353 n. 1 (1974) (Marshall, J., concurring) citing 1 K. Davis, *Administrative Law Treatise* 2.01 (1958), or whether it stands as an authoritative ruling alongside other decisions of this Court.

Actually, in the instant case the constitutional problem in an administrative agency's refusal of permission to withdraw a registration statement is more squarely presented than it was in *Jones* because there the S.E.C. acted expeditiously whereas here the S.E.C. delayed for a lengthy time period and Petitioner was severely prejudiced as a result. In the instant case, Petitioner filed a broker dealer withdrawal request which was received by the S.E.C. on September 17, 1973 (Record pp. 1240, 1242). Under S.E.C. Rule 15b 6-1, 17 C.F.R. §240, 15b 6-1, the withdrawal request would have become effective on the 60th day thereafter, which was November 16, 1973, were it not for the fact that the same rule provides:

> "If a notice to withdraw from registration is filed with the Commission at any time subsequent to the date of the issuance of a commission order instituting proceedings pursuant to Section 15(c) to censure, suspend, or revoke the registration of a broker or dealer . . . the notice of withdrawal shall not become effective except at such time and upon such terms and conditions as the Commission deems necessary or appropriate in the public interest or for the protection of investors."

The effect of this rule, as applied by the S.E.C., is that the

S.E.C. will take no action on a broker dealer withdrawal request while an administrative proceeding is pending. A recent decision, *A.J. White & Co. v. S.E.C.*, 556 F. 2d 619, 624-625 (1st Cir. 1977), upheld the authority of the S.E.C. to do this. However, that decision did not discuss either Rule 15b 6-1 or the constitutional questions raised here but merely based its holding on the broad discretionary authority given to the S.E.C. in §15(b)(6) of the Securities Exchange Act to permit withdrawal under terms "appropriate in the public interest or for the protection of investors."

The constitutional problems involved in the refusal to permit a broker dealer to withdraw are evident in the instant case because this refusal continued for a period of more than seventeen months from November 16, 1973 until April 28, 1975, when Petitioner's broker dealer registration was revoked, particularly since it was during this seventeen-month period when many of the events occurred which the S.E.C. cited as the basis for its decision. In other words, the S.E.C. decided that it was "appropriate in the public interest" to require Petitioner to continue as a registered broker dealer from November 16, 1973 until April 28, 1975 and at that point found it was appropriate in the public interest to revoke Petitioner's broker dealer registration and to bar Petitioner from being associated with any broker or dealer. The illogic of this result is obvious and demonstrates the arbitrary and capricious nature of the actions of the S.E.C. The federal courts long have been aware of the problem of excessive delays by administrative agencies including the S.E.C., See *Gearhart & Otis Inc. v. S.E.C., supra* at 800, and authorities there cited. A prolonged refusal to permit the withdrawal of a broker dealer registration is especially prejudicial. Assuming that certain legal positions taken by the S.E.C. staff are correct, a broker dealer caught in the situation of Petitioner must maintain and keep current all of the required financial records, must file an annual certified financial statement as well as other required reports with the S.E.C., must pay required fees and assessments, and must maintain the required net capital for

an indefinite period of time while waiting for the S.E.C. to make up its mind. Moreover, since the S.E.C. insists that the required financial records be maintained in an "easily accessible place," a broker dealer in the position of Petitioner may be required to maintain an office and a staff. In short, a broker dealer in the position which Petitioner found himself is required to bear considerable burden and expense all because of the length of time it takes the S.E.C. to resolve its administrative proceeding. This situation creates abuses that the Sixth Amendment was intended to prevent. The effect of the burden of remaining as an involuntary broker dealer in the case of an individual sole proprietor such as Petitioner in this case was to make it prohibitively difficult to seek and obtain gainful employment outside of the securities area due to the necessity of devoting Petitioner's full attention to satisfying the myriad of S.E.C. requirements as well as fighting the S.E.C. in court. Moreover, a broker dealer which has filed a request to withdraw its registration has presumably ceased securities activity, as was the case with Petitioner here, and presumably would not be able to derive income from that source. In short, the actions or lack of action of the S.E.C. had the effect of making it virtually impossible for Petitioner to earn a living and to lead a normal sort of life or to gain an income from any source. This placed Petitioner in a terribly unfair position. The significance of this is demonstrated by the fact that the decision of the S.E.C. devoted as much attention to events which occurred after Petitioner had filed his broker dealer withdrawal request as it did to facts found from the testimony at the administrative hearing. As the petition points out, the administrative hearing was concluded on November 1, 1972 (Pet. 28) and no further testimony or evidence was received in the record after that date. After the Initial Decision by the Administrative Law Judge (Pet. App. 9a-22a) and the granting of a petition for review by the S.E.C., the final brief on behalf of Petitioner was filed on July 20, 1973 and the final brief on behalf of the S.E.C. was filed on August 14, 1973. As noted previously, on September 17, 1973 Petitioner filed a

broker dealer withdrawal request. This came as a result of a business decision to terminate Petitioner's activities as a broker dealer, due to a severe decline in the volume in the market in securities traded in the pink sheets. (It was not, as the Court of Appeals implies (Pet. App. 39a) as the result of an attempt to thwart the process of the S.E.C.'s administrative proceeding which had been commenced more than 16 months earlier). Thus, as the petition notes (Pet. 34-35) and the brief in opposition impliedly admits (Brief p. 6), the two court injunctions, dated January 18, 1974 and January 17, 1975, which now form the principal basis for the penalties invoked against Petitioner, (see Brief pp. 4-6) were both issued after Petitioner had gone out of business, after Petitioner had filed a broker dealer withdrawal request and long after the administrative hearing had been concluded and the record closed. The prejudicial nature of this is further demonstrated by the fact that it is apparent from the S.E.C.'s decision that had the S.E.C. decided this case in September, 1973 or thereabouts it would have invoked far less severe sanctions if any at all. For example, the section of its decision entitled "public interest" (Pet. App. 27a-29a) discussed solely events which occurred after September, 1973.

V

It should be noted that the brief in opposition filed by the S.E.C. continues the practice which has characterized briefs filed by the S.E.C. in the various district court proceedings, in the Court of Appeals, with the Administrative Law Judge and with the S.E.C. itself of making statements which, although sometimes not totally false, are calculated to create confusion and cause misunderstanding concerning the facts of the cases and the contentions of the parties. For example, the first paragraph of point 1 on page 5 of the brief in opposition appears to be calculated to create the misleading impression that Petitioner did receive notice that the permanent injunction and the second preliminary injunction might form the basis for the

Commission's imposition of sanctions. Of course, the only injunction alleged in the notice (Pet. App. 3a) and the only injunction which had been entered at the time of the administrative hearing was a preliminary injujction which was entered on June 24, 1971 by consent and without the defendant admitting or denying the charges. The Court of Appeals apparently misapprehended this point because in its decision it seems to state that it had dismissed an appeal from the preliminary injunction (see Pet. App. 41a) whereas, in fact, no appeal from that injunction had been taken.

Once any possible confusion on this matter is cleared up it is apparent that in its brief in opposition the S.E.C. is advancing a contention which it did not dare to advance to the Court of Appeals, namely: that the S.E.C. has the discretionary authority to revoke the broker dealer registration of any securities broker which has ever been enjoined, wither permanently or temporarily, by any federal court, even by consent. Since nowadays virtually every major securities broker dealer has at one time or another entered into the standard consent injunction, this contention, if correct, would give the S.E.C. the life or death discretionary authority over the existence of virtually every major broker dealer in the securities industry. Even if this result were authorized by statue, which it is not, see §15(b)(5) of the Securities Exchange Act, it would not be permitted by the Constitution. See e.g. *Brown v. Allen*, 344 U.S. 443, 496 (1952) where Mr. Justice Frankfurter observed "[d]iscretion without a criterion for its exercise is authorization of arbitratiness."

When read carefully, it can be seen that the brief in opposition admits that Petitioner did not receive notice that two court injunctions and an affidavit filed in the Court of Appeals would be relied upon by the S.E.C. in making its decision. Neither were these documents made part of the record or offered into evidence. It argues, however, that these matters involved "indisputable facts" (Brief in Opposition p. 6) and that "Petitioner's do not show how more explicit notice would have enabled them to refute these facts." *Id.* Presumably, the S.E.C.

likens this case to that presented in *Dixon v. Love*, No. 75-1513,—U.S.—(May 16, 1977), where this Court ruled that the Constitution did not require an administrative hearing prior to the revocation of a driver's license because matters of public record in that case required a mandatory revocation. One problem with this approach is that, forgetting the constitutional considerations, the applicable provisions of the Securities Exchange Act and the rules promulgated thereunder require prior notice and the opportunity for an administrative hearing whereas neither were required by law in the *Dixon* case. See §15(b)(5) and §15(c)(7) of the Securities Exchange Act. Moreover, the Administrative Procedure Act, 5 U.S.C. §556(d) as well as Rule 17(g)(2) of the Rules of Practice of the S.E.C., 17 C.F.R. §201.17(g)(2) require the S.E.C. to base all of its fact findings "on the record" and this clearly precludes fact findings based on events which took place after the record was closed.

In addition, the claim in the brief in opposition that the S.E.C. based its decision on "indisputable facts" is false. Rather, the S.E.C. made a purely subjective determination based on conclusions it reached without giving Petitioner notice or the opportunity to be heard. For example, it stated that Petitioner's conduct in 1974 and 1975 shows "his continuing disposition to disregard or defy the rules governing registered broker dealers." (See Brief in Opposition p. 4; Pet. App. 28a). Indeed, it is this sentence which seems to form the basis for the S.E.C.'s imposition of Draconian penalties in view of the unexceptional nature of the violations which were found based on the record of the administrative hearing. The S.E.C.'s conclusion is based not on any facts alleged in the order for public proceedings but rather on the two court injunctions and other matters which came up long after the administrative hearing was concluded. To impose penalties based on sweeping conclusions without giving Petitioner notice and the opportunity to be heard is clearly violative of both the Administrative Procedure Act, the Securities Exchange Act and the Rules of Practive of the S.E.C.; hence the order of the S.E.C. must be vacated. In addition, it is

apparent that the S.E.C. invoked the severe sanctions it did primarily because of statements made by Petitioner critical of the S.E.C. itself (See Pet. App. 28a, 35a n. 28). This result is barred by *Taylor v. Hayes*, 418 U.S. 488, 501-503 (1974).

It should also be said that the S.E.C. did not invoke sanctions merely upon the "indisputable facts" of the existence of the January 18, 1974 and January 17, 1975 injunctions but rather based its decision on its subjective evaluation of the significance of the findings of fact and other determinations made by Judge Ward. Indeed, it seems that the fact findings in the S.E.C.'s decision concerning the time period covered by the administrative hearing (Pet. App. 24a-26a) were copied largely from the decision rendered by Judge Ward since many of them have no support in the record of the administrative hearing. For example, decision of the S.E.C. finds that an S.E.C. staff investigator visited Petitioner's office on February 25, 1971 (Pet. App. 25a), whereas the Administrative Law Judge, who did not have the benefit of Judge Ward's decision and had only the record of the administrative proceeding before him, did not find that a visit had taken place at any time in February, 1971. (Pet. App. 11a). Thus, the S.E.C.'s finding may have been based on Judge Ward's decision rather than the record of the administrative hearing. See *S.E.C. v. Sloan*, 369 F. Supp. 996, 998 ¶9 (S.D.N.Y. 1974). Moreover, the decision of the S.E.C. discusses at length fact findings made by Judge Ward concerning events which occurred in 1973. (See Pet. App. 27a, 32a n. 19). This was clearly improper because the S.E.C. accepted these findings as proven evidentiary fact whereas they clearly were not supported by the record before the S.E.C. which did not cover events occurring in 1973. The purpose of judicial findings of fact is to aid appellate review, *Lemelson v. Kellogg Co.*, 440 F. 2d 986 (2d Cir. 1971) and to avoid prejudice to the parties. *Leighton v. One William Street Fund, Inc.*, 343 F. 2d 565, 567 (2d Cir. 1965). Clearly, it was improper for the S.E.C. to use a district court's findings of fact for a purpose for which they were never intended, namely as a collateral basis for the issuance of an order of an

administrative agency which did not have before it the transcript or the evidence upon which these findings were based.[4] Had Petitioner received notice that the S.E.C. was going to consider and evaluate Judge Ward's fact findings he would have had the opportunity to offer mitigating circumstances and to show that the conduct set forth in Judge Ward's fact findings was not willful and he would have had the opportunity to show that the fact findings Judge Ward made were not supported by the evidence as was the case with the particular fact findings cited in the S.E.C.'s decision. The S.E.C., in its brief to the Court of Appeals in Petitioner's appeal from Judge Ward's order of injunction, abandoned those fact findings, namely Judge Ward's findings No. 20 and 31.[5]

The cavalier attitude of the S.E.C. towards the notice and hearing requirement was recently taken to task by the Third Circuit Court of Appeals in a case involving parallel notice requirements in proceedings before the NASD. See *Todd & Co., Inc. v. S.E.C., supra.* The Court there ruled that one cause of action should have been dismissed by the S.E.C. because of the lack of notice. The Court therefore vacated the order of the S.E.C. and the matter was remanded to the S.E.C. for reconsideration of the sanctions. This last point is significant since it demonstrates that if even part of the findings of the S.E.C. are set aside, the proper course is a remand. The same conclusion was reached in *NLRB v. Pipefitters*, 429 U.S. 507, 522 n. 9 (1977).

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4. Petitioner was denied the right to have those findings reviewed by a proper reviewing court when the Court of Appeals *sua sponte* and without notice dismissed Petitioner's appeal of Judge Ward's injunctive order. *S.E.C. v. Sloan*, 538 F. 2d 13 (2d Cir. 1976) *cert. denied*, 429 U.S. 1023 (1976).

5. The brief the S.E.C. filed in that appeal argued that certain of Judge Ward's other findings of fact were supported by evidence and therefore it was unnecessary for the court to reach the question of the validity of all Judge Ward's findings.

VI

This demonstrates another error in the decision of the Court of Appeals since it affirmed the order of the S.E.C. without passing on the question of whether the S.E.C.'s findings of fact were supported by substantial evidence. It is clear that the Court of Appeals should have examined the evidence and had it found it to be insufficient it should have ordered a remand. Based on this analysis, this Court should at a minimum order this case remanded to the Court of Appeals with instructions to that Court to review the evidence in the record.

It does not require much thought to reach the conclusion that at least some of the findings of the S.E.C. could not have been supported by substantial evidence. For example, as the petition points out (Pet. 41), the S.E.C. "found" that Petitioner violated S.E.C. Rule 17a-11 on September 15, 1971 by not sending the S.E.C. a telegram stating that he had violated the net capital rule on that date (See Pet. App. 32a, n. 17). However, as the brief in opposition admits (Brief, p. 3, n. 1) the S.E.C. found violations of the S.E.C.'s net capital rule only in the months of January, February, June and July, 1971 and January, 1972. Therefore, the S.E.C. did not find that Petitioner had violated the net capital rule in September, 1971. Consequently it is obvious that the S.E.C. could not reasonably have found that Petitioner was required to send the S.E.C. a telegram on Sept. 15, 1971 notifying the S.E.C. that on that date he had violated the net capital rule. Therefore, the finding by the S.E.C. that Petitioner violated Rule 17a-11 on Sept. 15, 1971 is totally without basis. Accordingly, under *NLRB v. Pipefitters, supra,* and other authorities previously cited, this in itself is sufficient to require a remand to the S.E.C. Although the example just given is rather elementary and obvious, a detailed examination of the record will show that most of the other findings of the S.E.C. are seriously flawed in equally obvious ways. In other words, the claims made by the S.E.C. are, as Judge MacMahon characterized the presentation made by the S.E.C. in another case,

"confused, disjointed, unfocused, incoherent, and, at times, incomprehensible." See *S.E.C. v. Commonwealth Securities Inc.*, CCH Fed. Sec. Law Rep. ¶95, 495 (S.D.N.Y. 1976). It is noteworthy that the brief in opposition filed by the S.E.C. never states that the S.E.C.'s findings are supported by substantial evidence. In this respect, it is similar to the brief the S.E.C. filed in the Court of Appeals in this case, which, while arguing that there were ample grounds to support the order of the S.E.C., never claimed that the specific facts found by the S.E.C. were supported by substantial evidence and never cited pages of the transcript which supported all of the specific fact findings made by the S.E.C.

At this point it is appropriate to say that even the single section of the findings of fact of the S.E.C. which are quoted in the brief in opposition have little basis. The passage in question can be found in the brief in opposition, p. 3, n. 1. This footnote states, in part, that Petitioner did not challenge the findings of violations of the S.E.C.'s net capital rule in his appeal to the Commission. This is not correct. The first point that should be noted in this regard is that in the appeal in question Petitioner was appealing from the specific fact findings by the Administrative Law Judge. These fact findings can be found at Pet. App. 9a-22a. In comparing these fact findings to the findings ultimately rendered by the S.E.C. one can observe numerous discrepancies. Many of the most serious findings of misconduct by the Administrative Law Judge were not adopted by the S.E.C. Instead, the S.E.C. made new findings on matters not discussed by the Administrative Law Judge. In his brief to the Commission in the petition for review of the decision of the Administrative Law Judge, Petitioner's counsel understandably devoted most of his attention to refuting some of the wild and baseless charges which the Administrative Law Judge made including those found at Pet. App. 15a. It is true that the 12 page brief which Petitioner's counsel filed with the S.E.C. did not attempt to refute on a sentence by sentence basis every statement in the Administrative Law Judge's initial decision. However, he was

not required to since Rule 17(b) of the Rules of Practice of the S.E.C., 17 CFR §201.17(b), provides that the reasons for objections to the initial decision "may be stated in summary form" and Petitioner's brief and petition for review made it clear that he was protesting all of the findings of the Administrative Law Judge. It is also significant that during the period when Petitioner's counsel was preparing his brief to the Commission, he was denied access to the administrative proceeding transcript and was not allowed to make copies of the record. See *S.E.C. v. Samuel H. Sloan & Co.*, 369 Supp. 994 (S.D.N.Y. 1974); see also Record p. 1184-1186. This severely inhibited his ability to prepare a brief directly refuting every sentence contained in the decision of the Administrative Law Judge.[6]

With regard to the claim that Petitioner did not challenge the accuracy of the net capital computations prepared by S.E.C. staff investigators Bruder and Kanoff (Brief in Opposition p. 3, n. 1), it can be readily seen that this claim is incorrect. Petitioner's counsel cross-examined Bruder and Kanoff at length with regard to the accuracy of their computations and a reading of this transcript demonstrates that these computations were filled with errors. Kanoff, in fact, directly admitted, when confronted with the evidence, that his computations contain erroneous evaluations of the market prices of various securities included in the capital of the Petitioner. Transcript 232, 233, 249. The S.E.C. staff has made no effort to correct these errors. As for Bruder, the following section of the cross-examination concerning his computation of Petitioner's capital as of January 29, 1971 demonstrates his lack of understanding of the basic double entry system of bookkeeping and his unfamiliarity with the method by which net capital is computed. (Bruder, it must be remembered, was not an accountant and prior to his employment with the S.E.C. had been a margin clerk for a stock brokerage firm.) (Transcript 69-71):

6. The S.E.C. staff defended its actions on the grounds that Petitioner could purchase a copy of the 443 page transcript from the court reporter at the rate of $1.35 per page (Record p. 1184-1186).

"Q. What you are stating is that Mr. Sloan had told you previously that he had received $10,000?

A. Certain monies.

Q. From his mother?

A. Right.[7]

Q. And you found this in the capital account of Mr. Sloan?

A. Not in Mrs. Sloan, no.

Q. Mr. Sloan?

A. I found it in the capital account here.

Q. That is what I asked. Did you find it in the capital account of Mr. Sloan?

A. Yes.

Q. You did?

A. It was included.

Q. Why is the reason you have deleted it from his capital as of January 29th?

A. We could not ascertain that it was actual capital.

Q. Is there any question that the $10,000 amount is reflected among the assets on January 29th?

A. It is not recorded in the assets. I have it included in the liabilities, sir.

Q. Well, then, if you have done that. may I ask you, please, if the amount is not included among the assets, why would you include it among the liabilities?

A. Well, it would be included in over-all assets, maybe as cash in the bank or funds on deposit with another broker or it may be part of his fail to delivers.

Q. I asked you the question before, sir, is it, the $10,000, is it included among the assets, and you said no.

I asked you the next question—

7. Bruder apparently had a misunderstanding in a conversation with Petitioner because Petitioner never received $10,000 or any similar sum of money from his mother and his books and records did not reflect the receipt of that or any other amount.

A. I stand corrected. It is in there.

Q. Were you in error on that testimony?

A. On that one particular question, yes.

Q. Then, would you tell us again why you listed it among the liabilities, please?

A. We could not confirm that it was part of Mr. Sloan's capital.

We wrote a letter to Mrs. Sloan requesting that she had given it to him as a gift or as a loan.

It was not stated and we never received a reply.

Q. Would it be correct to state that if the mother of Mr. Sloan would verify that that was a complete gift, that it should be included as capital and not liability on January 29th?

A. Yes.

Q. Would that be correct, Sir?

A. Yes.

Q. Would you then say that if that be so, then this computation is in error?

A. If it was an actual gift, yes, sir."

Thus, based upon the mistaken assumption that Petitioner had received an "unconfirmed gift" in the amount of $10,000 from his mother. Bruder deducted that amount in his computation of Petitioner's net capital. That deduction was compounded when Bruder took an additional deduction based upon the ratio the net capital rule requires broker-dealers to maintain between "aggregate indebtedness" and net capital. Bruder included the $10,000 in his computation of Petitioner's aggregate indebtedness thereby increasing the net capital which Petitioner was required to maintain in order to be in compliance with the net capital rule. After making these and other erroneous computations, Bruder arrived at the conclusion that Petitioner had a net capital deficiency amounting to $11,912 (Pet. App. 31a, n. 11). Petitioner's accountant, however, filed with the S.E.C. a certified financial statement for the same date showing that Petitioner had excess net capital amounting to $4,529.99. As the Petitioner notes, the S.E.C. has never challenged the accuracy of that computation [8] (Pet. 55).

With regard to Bruder's other computation of net capital, namely his computation as of January 18, 1971 which can be found at Pet. App. 56a, the following cross-examination took place (Transcript 58-63):

Q. . . . Do you know for a fact that they are monies owed to customers as at January 18th, Mr. Bruder?

A. On over-all monies owed to customers. That is, there were more credit balances than debit balances.

Q. And you botained that information from the subsidiary ledger called customer ledger of Sloan & Co., is that right?

A. From the ledgers here.

Q. From the ledgers maintained by Sloan & Co.?

A. No. Yes, that's right, the ledgers maintained by Sloan & Co. [9]

Q. Could you tell us the names of those customers?

A. I cannot from this sheet.

Q. Did you make a schedule of those or a listing of those customers?

A. No, I did not.

Q. Why—

A. Because—

Q. Pardon me, Sir?

A. At that time I don't believe there was a complete list of them.

Q. I just asked you then, did you examine and find in the

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8. Pursuant to the Freedom of Information Act, the S.E.C. in 1976 gave Petitioner access to yet another computation by a member of the S.E.C. staff which states that Petitioner had a net capital deficiency of $1657.09 on the same date.

9. In fact, the ledgers maintained by Sloan & Co., which are presently in the custody of the clerk of the United States District Court for the Southern District of New York as part of the record of *S.E.C. v. Sloan & Co.*, 71 Civil 2695, show that there were no customer accounts open on the books of Sloan & Co.

customer ledger, which you said was maintained, did you find a schedule—pardon me.

Did you find balances totalling 11,010.13 as monies due to customers?

A. No, I did not.

Q. You did not find it in the customers' ledger then?

A. No.

Q. Where did you find or where did you establish such amount?

A. From the general ledger.

Q. In what accounts did you look?

A. There was an account set up, receipts and payments, account of customers.

Q. Did you examine both sides of that account?

A. That's the way—I examined both sides to see, and the total was that amount.

Q. What was the total of the debits in that account, sir, if you know?

A. I don't know, sir.

Q. And you don't know the amount of credits, other than, as you state, the net amount is 11,010.13?

A. Yes.

Q. Mr. Bruder, did you examine any other record that was not a ledger, that established that amount for you?

A. No.

Q. You insist that it was the customer's ledger.

A. I looked through a customer's ledger.

This balance came from the record of the general ledger.

Q. Was there a control account in the general ledger that showed this balance, sir?

A. No. There was no record in the control account.

Q. Then, if I understand you, is it your testimony that the general ledger trial balance prepared from the general ledger, would not contain this amount? Is that correct?

A. That's right. This is a balance which I took from Sloan's records.

Q. Some records of Sloan's?

A. Some records of Sloan's.

Q. Which you now identify as the customers' ledger?

A. Yes.

Q. Would it also be correct to say that the unaccounted for difference is not a general ledger trial balance account, in the amount of 10,043.90, that no such account exists?

A. That is an account that I put on the sheet to balance off the assets and liabilities.

Q. So would it be possible that you overlooked an account in the ledger?

A. I don't believe it would be possible.

Q. Would it be possible?

MR. RASHES: Your Honor, I think the witness just answered that question.

If you want to read it back—

JUDGE TRACY: Read the question.

MR. TAYLOR: I will withdraw it.

JUDGE TRACY: All right.

Q. Is it correct then or would it be possible that the customer account figure that you have also is in error?

That there is no such account in the general ledger for that amount?

A. What are you—

MR. RASHES: I object.

I don't believe Mr. Bruder—I think Mr. Bruder testified he took this from the general ledger.

A specific item described as receipts—receipts from our customers. I think this has been testified to already.

MR. TAYLOR: He also—

JUDGE TRACY: I don't think he testified anything is in error.

That is your statement.

MR. TAYLOR: I believe he testified that the 11,010.13 was not a ledger account.

JUDGE TRACY: That doesn't mean it was in error, does it?

MR. TAYLOR: It doesn't say it was, either, your Honor.

JUDGE TRACY: As I understand it, he took the figure off the books and records of Mr. Sloan. He didn't go back to the subsidiary supporting documents to see if it was properly booked. He at least took it off the general ledger account, which had that much difference in it.

MR. TAYLOR: I would submit that is not his testimony.

Without prejudicing my examination, I will tell you my testimony on the direct case will be entirely contrary to that.

That is what I am—that is why I am trying to get him down to the rationale of why he did it.

JUDGE TRACY: All right.

BY MR. TAYLOR:

Q. Would it be correct to say, in any event, Mr. Bruder, that the Exhibit 3, which you have before you, was prepared from the books and records of Sloan & Co.?

MR. RASHES: I believe he has Exhibit 4, Mr. Taylor.

MR. TAYLOR: Is that 4?

MR. RASHES: Yes.

MR. TAYLOR: I beg your pardon, that is 4.

First time you are right today.

Q. Is that correct, sir, that these schedules that you ultimately finalized, were prepared from the books and records of Sloan?

A. Yes, sir.

In view of the above cross-examination and the cross-examination with respect to the computations of capital on all of the other dates cited in the decision of the S.E.C. plus the brief filed by Petitioner's counsel, it was absurd for the S.E.C. to suggest that Petitioner "does not challenge those findings" of violations of the S.E.C.'s net capital rule (See Pet. App. 26a). Moreover, assuming that Petitioner's counsel committed a procedural default under the Rules of Practice of the S.E.C., which is essentially what the S.E.C. contends, the Court of Appeals was still obliged by §25(a)(4) of the Securities Exchange Act to determine if the findings of fact were supported by

"substantial evidence" in the record irrespective of the S.E.C.'s procedural rules. If the "substantial evidence" test is applied, there is clearly insufficient evidence under any test to support the findings by the S.E.C.

Incidentally, in the direct examination of Bruder and Kanoff, no explanation was given or attempted of the method of computing net capital or the process by which they arrived at their computations. In the case of each computation, either Bruder or Kanoff was asked to state the bottom line figure at which he arrived and then the computation was received into evidence without further explanation or analysis. This placed the total burden on Petitioner's counsel to explore, through cross-examination, the method by which these computations were made as well as their accuracy. Judge Ward, in the trial before him of the S.E.C.'s parallel injunctive suit, permitted the S.E.C. the same latitude.

VII

In page 3, footnote 1 of the brief in opposition there is a direct quotation from two sentences of the decision of the S.E.C. These sentences state:

> "Sloan's own testimony shows that he engaged in the securities business . . . from January to July 28, 1971. And in January of 1972 he inserted quotations for various securities in the . . . quotation listings published by the National Quotation Bureau, Inc."

Petitioner's brief to the Court of Appeals in this case pointed out that neither sentence was supported by any testimony or evidence in the record. Significantly and charac teristically, the brief in opposition does not cite any pages of the record where evidentiary support for these two sentences can be found nor could it do so, because, as a matter of fact, Petitioner never testified that he engaged in the securities business from January to July 28, 1971 and neither he nor the two S.E.C. in-

vestigators who testified at the hearing stated that he had inserted quotations in the pink sheets in January, 1972. Moreover, as the Petition (Pet. 44 and n. 6) points out, the question of whether Petitioner inserted quotations in the pink sheets in January, 1972 is more susceptible to documentary proof than to testimonial recollection. The only proper way to prove that Petitioner inserted quotations in the pink sheets in January, 1972 would be for the S.E.C. to produce a pink sheet containing a quotation submitted by Petitioner. The S.E.C. did not do so and an examination of the record leads reasonably to the conclusion that Petitioner in fact did not insert bid and asked quotations in the pink sheets in January, 1972. It is worth adding that the Order for Public Proceedings (Pet. App. 1a-4a) contains no allegation that Petitioner inserted quotations in the pink sheets in January, 1972 or at any other time.

Another thing which should be said about footnote 1 of the brief in opposition concerns the findings of the Administrative Law Judge which the S.E.C. said Petitioner "did not challenge." If one will look at Pet. App. 13a one will see two columns of figures. These show that the Administrative Law Judge did not make a precise determination of Petitioner's net capital on the various dates in question. Instead he set forth alternative figures for most of the dates and did not purport to decide which of the two sets of figures were correct. The S.E.C. itself, without any discussion of this situation, merely adopted the figure in the right hand column which was invariably the lower figure when the two columns differed (See Pet. App. 31a). The exception to this practice concerned the January 31, 1972 date where the right hand column of the Administrative Law Judge's figures did not set forth any net capital deficiency. This circumstance demonstrates that Petitioner did not receive notice of precisely what net capital violations were being alleged even as late as the time of his appeal to the S.E.C. from the decision of the Administrative Law Judge and that the S.E.C. staff itself is uncertain of how net capital is to be computed, a circumstance which has constitutional implications. See Pet. 4, Question 6.

The final thing which should be said about footnote 1 of the brief in opposition concerns the statement made in the decision of the S.E.C. that Petitioner "merely challenged the finding that he had engaged in business between the end of July and September, 1971 (Pet. App. 26a)." This statement regarding an argument Petitioner was making is misleading. An examination of the initial decision of the Administrative Law Judge reveals the absence of any finding that Petitioner was doing business at any time with the exception of a finding that "registerant engaged in new business in July, August and September, 1971." (Pet. App. 14a). Accordingly, Petitioner presented an argument in his appeal to the S.E.C. in accordance with numerous S.E.C. interpretative decisions which have stated that a "willful" violation of Rule 15c 3-1 occurs only when a broker dealer conducts a securities business while its aggregate indebtedness exceeds 2,000 per cent of its net capital. See e.g. *In the Matter of Superior Securities Co. Inc.*, Securities Exchange Act Release No. 34-7767, CCH Fed. Sec. Law Rep. ¶77,312 [1964-66 Transfer Binder]. See "Capital Deficiencies—Securities Transactions," CCH Fed. Sec. Law Rep. 25, 135 headnote.25 [Exchance Act Binder] which cites 57 decisions in which the S.E.C. has adhered to this holding. The rationale of this is that it is not a violation of any statute or rule for a broker-dealer to go broke but it is a violation of the S.E.C.'s net capital rule for a broker-dealer to do business when he has a "net capital deficiency" as defined by the rule. Accordingly, Petitioner understandably felt that he need merely refute the finding that he did business in July, August and September, 1971, which was the only finding in the initial decision that he did business at any time, to defeat the S.E.C. staff's allegation that he violated the net capital rule. However, the S.E.C. proceeded to rule that it was "unnecessary to reach" Petitioner's contentions (See Pet. 32a, n. 15) because it was making a finding not made by the Administrative Law Judge that Petitioner "engaged in the securities business . . . from January to July 28, 1971."

VIII

This again demonstrates the problem Petitioner faced due to the lack of notice. Although the Order for Public Proceedings recites statutory language by alleging that Petitioner "used the means and instrumentalities of interstate commerce to effect transactions" (Pet. App. 2a) it does not state what Petitioner did and when and where he did it. Although Petitioner filed a motion for a more definite statement, the Administrative Law Judge denied this motion with a ruling that "it is not necessary for the notice of proceedings to detail and itemize 'all the particular acts, which together constitute the offense' " (Pet. App. 6a). Thus, Petitioner was forced to proceed to the hearing without having the foggiest idea of what, for example, means and instrumentalities the S.E.C. staff was alleging that he had used. That still has not been clarified (See Pet. 5, 64). Petitioner did not have a concrete notion of what the charges were until the S.E.C. staff filed its "proposed findings of fact and conclusions of law," which was after the administrative hearing. Under the Rules of Practice of the S.E.C., the contentions of the S.E.C. staff were narrowed by the initial decision of the Administrative Law Judge to the extent that some of them were rejected (See Initial Decision Pet. App. 22a, n. 17). This is because the S.E.C. staff did not file a petition for review of the Administrative Law Judge's decision and under Rule 17(g) of the Rules of Practice the only questions before the S.E.C. concerned the objections filed by Petitioner. Specifically, Rule 17(g) states:

> "*Scope of review.* (1) Review by the Commission of an initial decision by a hearing officer shall be limited to the matters specified in the order for review. On notice to all parties, however, the Commission on review may raise and determine any other matters which it deems material, with opportunity for oral or written argument thereon by the parties.
>
> (2) On review the Commission may affirm, reverse,

> modify, set aside or remand for further proceedings, in whole or in part, the initial decision by the hearing officer and make any findings or conclusions which in its judgment are proper on the record."

Under this rule, the S.E.C. had no authority to make findings on matters not covered by the initial decision of the Administrative Law Judge without prior notice to all parties and the proposed findings of fact submitted by the S.E.C.'s staff prior to the initial decision no longer were issued due to the failure of the S.E.C. staff to seek review of the initial decision. Therefore, Petitioner filed a terse twelve-page brief which addressed itself solely to the findings made in the initial decision of the Administrative Law Judge. By making findings of fact based upon its own "independent review of the record," (Pet. App. 30a, n. 2) which included findings on matters not covered in the initial decision, the S.E.C. violated its own procedural rules as well as §15(b)(5) and §15(b)(7) of the Securities Exchange Act and the due process clause of the Fifth Amendment to the Constitution.

Here, it should be noted that the initial decision contained numerous generalities concerning the importance of the S.E.C. rules in question, as well as broad assertions that Petitioner had violated those S.E.C. rules, but set forth few specific or detailed facts. For example, the only sentence dealing with bookkeeping violations after January 25, 1971 stated (Pet. App. 11a-12a):

> "Subsequent visits to registrant's office by another Commission investigator in March, April, May, June and August, 1971 disclosed that the books and records were not in compliance and on at least one occasion were not available for inspection."

No further elaboration was given as to what these violations consisted of specifically. The decision of the S.E.C. subsequently found that violations of the S.E.C. bookkeeping rules had been observed during a visit by an S.E.C. investigator to Petitioner's office on February 25, 1971 (Pet. App. 25a). The initial decision

did not find that a visit had occured on that date or on any date in February, 1971. As the Petition notes (Pet. 68), it appears from material obtained subsequently under the Freedom of Information Act that the February 25, 1971 visit never took place.

The brief which the S.E.C. staff filed in response to Petitioner's appeal to the Commission never defended, by citing pages of the record, the specific fact findings in the initial decision by the Administrative Law Judge. Instead, it stated that "the Commission is respectfully referred to the Division's Findings and briefs submitted" (Record p. 1231). The term "Division" meant the "Division of Enforcement" of the New York Regional Office of the S.E.C. (See Pet. App. 9a). In its conclusion, the S.E.C. staff stated "the vast majority of the *Division's* allegations and findings remain unanswered and unrefuted." (emphasis added) (Record p. 1237). Note that this brief did not state that the findings of the Administrative Law Judge were unanswered and unrefuted. Rather, the S.E.C. staff requested the Commissioners to ignore what the Administrative Law Judge had said and rely on the Division's proposed findings of fact, a course which the S.E.C. ultimately took in part when it rendered a decision based upon "an independent review of the record" (Pet. App. 30a, n. 2) in clear violation of Rule 17(g) and the Administrative Procedure Act, 5 U.S.C. §556(d), which states that "sanctions may not be imposed . . . except on consideration of . . . those parts of the record cited by a party" (See Pet. 8). Except for the initial brief which was filed immediately after the administrative hearing, the S.E.C. has to this day never filed a brief which, by citing to pages of the record, showed where there was substantial evidence in the record supporting the decision sought to be reviewed. In other words, in its brief to the S.E.C. on review of the initial decision, the S.E.C. staff did not cite pages showing where there was evidence to support the findings of the Administrative Law Judge and likewise in its brief to the Court of Appeals the S.E.C. did not attempt to show where one could find the evidence supporting the findings of the S.E.C Similarly, in the parallel case resulting in the decision reported

as *S.E.C. v. Sloan*, 369 F. Supp. 996 (S.D.N.Y. 1974), the S.E.C. declined to file a post-trial brief and instead preferred to rely on its proposed findings of fact submitted prior to the trial (which were a virtual carbon copy of the proposed findings of fact filed with the Administrative Law Judge with a bit of updated material) and in its brief to the Court of Appeals in response to the appeal of that decision, the S.E.C. again chose not to tell the judges where to look to find evidence supporting the decision. In *S.E.C. v. Commonwealth Securities, Inc.*, CCH Fed. Sec. Law Rep. ¶95,495 [1976 Binder], Judge MacMahon explained the problem presented when the S.E.C. proceeds in this manner:

> "The complaint in this action rambles for some thirty-four pages and alleges violations of ten statutes and six rules of the Securities and Exchange Commission ("SEC") by fifteen defendants. The presentation of the case upon the trial was confused, disjointed, unfocused, incoherent and, at times, incomprehensible. Nor were the post-trial briefs of any assistance whatever in marshalling the evidence and relating it to the legal contentions of the parties. This has placed an intolerable burden upon the limited time and resources of a busy trial judge in this congested district.
>
> "Criminal cases under the securities laws and mail fraud statutes, involving equally complex transactions, are routinely tried and disposed of in this court in a fraction of the effort and time devoted to this poorly presented case. Here, we have been put to the almost endless and certainly exhausting task of trying to bring order out of chaos. Nonetheless, we must deal with the issues of fact in light of the applicable law as best we can perceive them under the circumstances."

In the case presented here the S.E.C. has changed its tune at every step and there are significant differences between the arguments presented to this Court and the arguments which were presented to the Court of Appeals. (See e.g. Brief in Op-

position p. 6 point 2, last sentence). With regard to the initial decision, the S.E.C. staff must have known that it contained numerous errors. For example, the initial decision states (Pet. App. 14a) that on July 28, 1971 Petitioner agreed with the S.E.C. "to cease doing a retail business" and "to liquidate customer accounts" whereas, as the S.E.C. staff well knew, Petitioner never did a retail business and consequently had no customer accounts to liquidate and his entire business had never consisted of more than "personal business" which consisted of buying and selling securities for his own account. Had the Administrative Law Judge perceived this, as he should have been able to do from examining financial data put into evidence by the S.E.C., (see e.g. Record p. 501 which states "The stock record or stock proof maintained should be viewed in the light of the firm doing no customer business"), he might have made a different decision. More significant at the present late stage, the S.E.C.'s refusal ever to admit that glaring errors like this were made below is reprehensible. As Judge Haight recently stated in *United States v. Fields*, CCH Fed. Sec. Law Rep. ¶96,074 [Current Binder] (decided June 3, 1977), which dealt with the activities of Jeffrey Tucker and William Nortman, the two S.E.C. attorneys who acted in a supervisory capacity during the life of the instant case:

> "It is a sad irony that representatives of a governmental agency dedicated to the prevention of fraudulent and misleading statements fell into this particular pattern of behavior."

IX

Finally, the brief in opposition states that all of the other claims presented in the petition were "correctly rejected" by the Court of Appeals. However, certain claims presented in the petition to this Court were not presented to the Court of Appeals because it was impossible to do so. These claims concern memoranda and other documents from the files of the S.E.C.

which were released to Petitioner in April, 1977 by order of the S.E.C. pursuant to the Freedom of Information Act. These matters are discussed at Pet. 46, 65-68. Certain of the documents in question would clearly form a basis for reopening this proceeding before the S.E.C. based upon newly discovered evidence, fraud by an adverse party or related grounds since they state on their face that certain violations found in the decision of the S.E.C. did not occur, were it not for the fact that the S.E.C. has no procedure for reopening a proceeding based upon newly discovered evidence or any other ground for that matter. Indeed, the S.E.C. staff has filed a memorandum stating that the S.E.C. has no jurisdiction to reconsider this case. (See Pet. 69, n. 17). The brief in opposition does not dispute this point.

It is true that Petitioner made the same argument to the Court of Appeals but it was based on different, and less convincing, material which was released to Petitioner in 1976 shortly before the oral argument in that Court. This material was presented to the Court of Appeals in the form of a motion for "leave to adduce additional evidence" as authorized by §25(a)(5) of the Securities Exchange Act. The Court of Appeals took no action on this motion and its decision shows why it did not feel the need to do so because it states that each of the two injunctions obtained by the S.E.C. "was in itself a sufficient grounds to support the revocation of Sloan's broker-dealer license" (Pet. App. 41a). In so doing, the Court of Appeals held that questions concerning the evidence and the validity of the S.E.C.'s fact findings were irrelevant. If that erroneous determination is not reversed by this Court, then the door will be closed to any efforts Petitioner might undertake to obtain reconsideration based upon newly discovered evidence or other related grounds. This circumstance is further demonstrated by the fact that one of the two injunctions cited by the Court of Appeals, namely, the preliminary injunction dated January 17, 1975, had been vacated and the underlying case dismissed as moot before the Court of Appeals made its November 18, 1976 decision and the Court of Appeals clearly viewed this

development as being irrelevant. Thus, even if Petitioner were able to open the remaining January 18, 1974 injunction based upon newly discovered evidence or mootness, that would in no way affect the lifetime bar which now prevents Petitioner from ever being associated with any broker or dealer.

X

This again demonstrates the validity of one point which merits restating even though it was not discussed in the brief in opposition other than being one of many characterized as being "frivolous" (Brief in Opposition, p. 5), namely, the point concerning the constitutionality of the statute. Sections 15(b)(5) and 15(b)(7) of the Securities Exchange Act authorize a revocation and a bar, respectively, upon a showing that a respondent to an administrative proceeding has been "permanently or temporarily enjoined by order, judgment or decree of any court." Under the reading of this statute adopted by the Court of Appeals and supported by the brief in opposition, even a non-reviewable temporary restraining order or an injunction subsequently reversed on appeal or long since expired or vacated can "in itself form a sufficient basis for a broker dealer revocation." If this interpretation of the statute is correct, then the statute is clearly unconstitutional.

The only safeguards Congress provided to this interpretation of the statute lie in the requirement that there be (1) notice and the opportunity for a hearing and (2) a finding by the S.E.C. that the sanctions invoked are in the "public interest." As to the first of the two safeguards, the petition amply demonstrates and the brief in opposition admits that Petitioner did not receive notice and the opportunity to be heard with respect to all of the charges. As to the second, it is apparent that Congress did not set forth in the Securities Exchange Act any standards to guide the S.E.C. in its determination of what constitutes the "public interest" and this matter is not covered by S.E.C. rules or other statute or authority. The term "public interest" is itself

broad and vague and cannot be said to constitute any judicially cognizable standard. As the petition notes (Pet. 69), it is clear from numerous decisions of this Court that a delegation of authority by Congress to an administrative agency without standards is an unconstitutional delegation of legislative power. See e.g. *National Cable Television v. United States,* 415 U.S. 336, 342 (1974). Therefore, Securities Exchange Act §15(b)(5), §15(b)(7) and, for the same reason, §12(k), which covers the trading suspension aspects of this petition, are all unconstitutional.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition herein should be granted.

Respectfully submitted,

Samuel H. Sloan

Dated: New York, New York
September 21, 1977